

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2008-251-E - ORDER NO. 2009-373

JUNE 26, 2009

IN RE:	Application of Carolina Power & Light)	ORDER APPROVING
	Company d/b/a Progress Energy Carolinas,)	DSM/EE APPLICATION
	Inc. for the Establishment of Procedures for)	
	DSM/EE Programs)	

Pursuant to S.C. Code Ann. § 58-37-20 (Supp. 2008) and S.C. Code Ann. Regs. 103-819, 103-820 and 103-823 (Supp. 2008), this proceeding before the Public Service Commission of South Carolina (“Commission”) concerns the Application of Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc. (“PEC” or the “Company”) to establish procedures that encourage PEC to invest in cost effective energy efficient technologies and energy conservation programs. In their application, PEC also requests the Commission approve the establishment of an annual rider to allow recovery of all costs associated with such programs and the recovery of an appropriate incentive for investing in such programs.¹ Notice of this matter was published by PEC in newspapers of general circulation in the areas affected by its request to inform interested parties of the manner and time in which to file the appropriate pleadings to participate.

Intervenors in the proceeding included Southern Environmental Law Center, Coastal Conservation League, Natural Resources Defense Council, and the Southern

¹ Commission Order 2009-435 addresses PEC’s requested Rider DSM/EE-1 allowing for the recovery of the costs associated its Demand Side Management and Energy Efficiency programs.

Alliance for Clean Energy (collectively “Environmental Intervenors”) as well as Nucor Steel – South Carolina, a Division of Nucor Corporation (“Nucor”), and Wal-Mart Stores East, LP (“Wal-Mart”). The South Carolina Office of Regulatory Staff (“ORS”) was a party pursuant to S.C. Code Ann. § 58-4-10 (Supp. 2008). On January 23, 2009, PEC, Nucor, Wal-Mart, and ORS (“Stipulating Parties”) filed a Stipulation Agreement resolving their issues. The Stipulation Agreement included a Demand Side Management (“DSM”) and Energy Efficiency (“EE”) (collectively “DSM/EE”) cost recovery mechanism and procedure (the “DSM/EE Procedure”) that addressed the recovery of PEC’s DSM/EE costs, the recovery of net lost revenues, a performance incentive to encourage PEC to aggressively pursue DSM/EE programs, and the filing procedures and requirements for establishment of a rider to allow recovery of PEC’s DSM/EE program costs. However, the Environmental Intervenors remained opposed to the DSM/EE proposal. An evidentiary hearing was held on February 12, 2009.

At the hearing, PEC was represented by Len S. Anthony, Esquire, and presented the testimony of B. Mitchell Williams, Manager of Regulatory Affairs, as well as Laura Bateman, Manager of Regulatory Planning. The Environmental Intervenors were represented by Christopher K. DeScherer, Esquire, and Sarah Rispin, Esquire, and presented the testimony of J. Richard Hornby, a consultant with Synapse Energy Economics, Inc., as well as Brian M. Henderson, an independent energy consultant. Wal-Mart was represented by Thomas L Moses, Esquire, and Holly Rachel Smith, Esquire, and presented the testimony of Steve W. Chriss, Manager of State Rate Proceedings. Nucor Steel – South Carolina was represented by Michael Lavanga, Esquire, and Robert

R. Smith, Esquire, but presented no testimony. ORS was represented by Jeff Nelson, Esquire, and Shealy Boland Reibold, Esquire, but also presented no testimony.

Contemporaneous with its South Carolina proceeding, PEC witness Williams testified that the Company was involved in a Demand Side Management/Energy Efficiency cost recovery proceeding in North Carolina. Williams also stated that following the filing of PEC's June 27, 2008 Application with this Commission, it entered into simultaneous and parallel negotiations with the North Carolina Utilities Commission Public Staff and Wal-Mart in North Carolina as well as ORS, Nucor, and Wal-Mart in South Carolina to mutually agree on an appropriate DSM/EE cost recovery mechanism. Tr. 36. Additionally, PEC reached agreement with the North Carolina Public Staff and Wal-Mart prior to the hearing in the South Carolina docket and, therefore, revised its proposed DSM/EE cost recovery procedure in this proceeding to be consistent with the settlement reached in North Carolina. *Id.*

These revisions were explained in Williams' January 8, 2009 prefiled testimony and detailed in the exhibit attached to this filing. During the hearing, Williams testified that PEC's January 14, 2009 filing, titled "Procedure and Mechanism for Recovery of Costs and Incentives for Demand-Side Management and Energy Efficiency Programs" clarified and combined into a single document PEC's Application, as revised, to be consistent with the North Carolina settlement. Thereafter, ORS, Wal-Mart, Nucor, and PEC reached an agreement on the South Carolina DSM/EE Procedure that closely reflects PEC's January 14, 2009 filing. The agreed upon DSM/EE Procedure and Stipulation Agreement were filed with this Commission on January 23, 2009.

BASIS FOR PEC'S APPLICATION

According to Williams, Tr. 10-130, PEC requests the establishment of its proposed DSM/EE Procedure because the electric industry is going through a transformation. He explained that traditionally an electric utility's duty was to provide a reliable supply of electricity to its customers at the lowest reasonable price, leaving use of that electricity solely to the discretion of the individual consumer. Primarily, attempts to influence the consumption of energy have been limited to the use of price signals, such as those employed by PEC in its time-of-use and curtailable rate schedules, where the Company provides a credit in exchange for its ability to interrupt power supplies during times of peak demand. He further explained that since South Carolina has relatively low electric rates, customers typically may not see DSM/EE programs as economically beneficial which may result in low participation and could cause few DSM/EE programs to be cost-effective.

However, Williams testified that while South Carolina continues to enjoy some of the lowest electricity rates in the nation, the cost of coal and natural gas has increased precipitously over the past few years, resulting in increases in electricity rates. Moreover, South Carolina's electric utilities have "grown into" the base load generation facilities constructed over the last two decades and all of South Carolina's electric providers are in the position of having to add a substantial amount of base load generation during the next ten (10) years. The cost of this new base load generation is forecasted to be substantially greater than the average cost of the utilities' existing generation mix.

As a result, Williams explained that DSM/EE programs are expected to become more cost-effective and therefore much more prevalent and expansive than has historically been the case. According to PEC, while these programs may be cost effective from the customers' perspective, it must be recognized that DSM/EE Programs are designed to encourage customers to reduce their consumption of the utility's electricity. This case is especially true for EE Programs. In other words, through these programs and measures, utilities are spending money to encourage their customers not to buy their product. Williams emphasized that this fact is completely inconsistent with any normal business plan and the resulting reduction in energy sales causes a loss of revenue which imperils the utility's ability to recover its costs. To properly compensate and encourage PEC to invest in and promote such programs, Williams stated that it is appropriate to provide PEC with timely cost recovery of all DSM/EE costs incurred, a mechanism to recover net lost revenues, and an appropriate incentive for promoting such programs. Tr. 37.

The Commission agrees with PEC witness Williams and finds that South Carolina's utilities should aggressively pursue and implement cost effective DSM/EE programs for the benefit of their customers.

Williams further explained that the DSM/EE Procedure agreed to by PEC, ORS, Nucor, and Wal-Mart, specifically the program cost recovery, recovery of net lost revenues, and an incentive/reward element, is consistent with S.C. Code Ann. § 58-37-20 (Supp. 2008). The Commission recognizes that this statute authorizes the adoption of procedures that encourage electric utilities to invest in cost effective energy efficient

technologies and energy conservation programs. Furthermore, we also recognize the statute provides that if the Commission chooses to adopt such procedures these procedures must:

1. Provide incentives and cost recovery for electric utilities that invest in energy supply and end-use technologies that are cost effective, environmentally acceptable, and reduce energy consumption or demand;
2. Allow electric utilities to recover their costs and obtain a reasonable rate of return on their investment in qualified demand-side management programs sufficient to make these programs at least as financially attractive as construction of new generating facilities; and
3. Establish rates and charges that ensure that the net income of an electric utility after implementation of specific cost effective energy conservation measures is at least as high as the utility's net income would have been if the energy conservation measures had not been implemented.

S.C. Code Ann. Section 58-37-20 (Supp. 2008)

ELEMENTS OF THE PROPOSED DSM/EE PROCEDURE

The DSM/EE Procedure consists of an annual rider to allow PEC to recover the following costs and incentives: (1) the actual costs incurred in providing the DSM/EE programs (including a return on PEC's investment)²; (2) the recovery of net lost revenues

² DSM/EE expenses will be deferred and amortized over a ten (10) year period using a levelized rate. The unamortized balance will earn a return equal to PEC's rate of return authorized in its last general rate case. DSM/EE capital expenditures will be depreciated over the useful life of the equipment with a return based upon PEC's current capital structure, current embedded cost of debt, and cost of equity as determined in PEC's last general rate case.

resulting from these programs³; and (3) an incentive equal to 8% of the net present value of the net benefits associated with each DSM program as calculated using the Utility Cost Test, and 13% of the net present value of the net benefits associated with each EE program as calculated using the Utility Cost Test. Tr. 39-40.

Williams explained in detail how these three elements of the DSM/EE Procedure are authorized by and consistent with S.C. Code Ann. § 58-37-20. Tr. 38-40. He testified that the statute requires a utility be allowed to recover its costs and obtain a reasonable rate of return on its investment. The DSM/EE Procedure does that in allowing PEC to recover all of its costs incurred in offering a DSM/EE program, including a return on any capital expenditures made in furtherance of such programs.

Regarding the second element of the DSM/EE Procedure (the recovery of net lost revenues), the statute provides that the Commission is to establish rates that ensure that the net income of the utility after implementation of DSM/EE programs is at least as high as the net income would have been if the DSM/EE programs had not been offered. By allowing PEC to recover its net lost revenues, this requirement of the statute is met.

Finally, regarding the third element of the DSM/EE Procedure, the recovery of an incentive/reward, the statute provides that the rate established by the Commission must be sufficient to make the utility's DSM/EE programs at least as financially attractive as construction of new generation facilities. By definition, investments in supply-side

³ For purposes of this Docket, the parties have stipulated that the term "net lost revenues" means the revenue losses, net of marginal cost avoided at the time of the lost kilowatt-hour sales or in the case of purchased power, in the applicable billing period, incurred by PEC as a result of a new DSM/EE program. Net lost revenues are also net of any increases in revenues resulting from activity by PEC's public utility operations that cause a customer to increase demand or energy consumption. PEC will be allowed to recover net lost revenues for three years from the installation of a measure as part of a DSM/EE program, or until PEC's next general rate case when any lost revenues are addressed, whichever time period is shorter.

generating facilities are much more capital intensive than demand-side resources and therefore have the potential to produce higher earnings for the utility. Allowing PEC to recover 8% for DSM programs and 13% for EE programs of the net present value of the net benefits associated with such programs as calculated using the utility cost test appears to be a reasonable incentive/reward under S.C. Code Ann. § 58-37-20 for implementing DSM and EE programs, fairly balancing the interests of the utility, consumers, and the public interest.

We find that the DSM/EE Procedure proposed by the Company is entirely consistent with S.C. Code Ann. § 58-37-20 and is a transparent and easily understood cost recovery procedure.

TREATMENT OF INDUSTRIAL AND LARGE COMMERCIAL CUSTOMERS

Witness Williams explained that all customer classes are not addressed in the same manner under the DSM/EE Procedure. Tr. 40-41. This distinction between customer classes results because substantial differences exist between small customers and large customers in their awareness of the benefits of DSM/EE programs and their willingness and ability to develop and implement them on their own. Large commercial customers (defined as customers that consume at least a million kilowatt-hours per year) and industrial customers are typically very conscious of their energy costs and already have a substantial incentive to invest in DSM/EE programs tailored to each individual customer's unique facilities and production processes, since it is cost effective for them to do so. These customers are better positioned than anyone else to make the decision on

whether a particular DSM or EE program would be suitably cost effective and operationally effective for their plants and facilities. Tr. 41.

Given that the incentive and opportunity already exists for large commercial and industrial customers to invest in DSM/EE programs even without the proposed DSM/EE Procedure, these customers should be able to opt out upon notification to PEC and not be required to contribute to the cost of the programs being provided to those customers who have not made such investments and are being provided incentives to do so by PEC. Additionally, requiring large commercial and industrial customers to fund PEC's DSM/EE programs could be anticompetitive where a customer that already has its own programs is being required to pay for PEC programs that are or might be used by its competitors. Moreover, large customers are simply not in a position to bear additional costs for EE and DSM programs that do not apply to them. The outcome of imposing such costs on these types of customers, while many other states do not, could result in a negative impact on business retention and economic development in South Carolina. We recognize that these concerns are particularly acute today, when large commercial and industrial customers are facing difficult economic conditions and competitive pressures.

The customers most likely to participate in and directly benefit from utility-sponsored DSM/EE programs are the residential and small commercial segments, and PEC's programs will target these customer segments. By participating in Progress's DSM/EE programs, these customers will receive the direct and tangible benefits of lower energy costs. It is appropriate that the customer segments which benefit also have responsibility for the cost of the programs, and those larger customers most likely to

finance and install energy efficiency improvements on their own should not be required to pay for utility-sponsored programs not directly benefitting them.

Therefore, the DSM/EE Procedure does not provide for any of the costs of new DSM/EE programs to be assigned to large commercial or industrial customers who opt out by notifying PEC that the customer has implemented or will implement alternative DSM/EE programs at its own expense and does not wish to participate in PEC's DSM/EE programs. However, any large commercial or industrial customer that elects not to participate in PEC's DSM/EE programs, but subsequently elects to participate in any new DSM/EE program, will lose the right to be exempt from payment of the annual rider for five (5) years or the life of the program, whichever is longer.⁴

Wal-Mart witness Chriss confirmed that large customers such as Wal-Mart constantly search for and implement those DSM/EE programs that are cost effective for their business operations. Tr. 321-325. Chriss gave numerous examples of actions taken by Wal-Mart to lower its energy costs. Tr. 322-323. In addition, Witness Williams testified that Nucor, a steel recycler and PEC's largest customer, has been served for many years under a time-of-use curtailable rate. Tr. 49. Williams further testified that Nucor's rate already provides peak demand reduction benefits of the type PEC hopes to achieve through the proposed DSM/EE Procedure. *Id.*

The Commission agrees and finds that large commercial customers and industrial customers should be allowed to opt-out of PEC's DSM/EE programs as provided for under the DSM/EE Procedure. Based on the evidence in this proceeding, these customers

⁴ Life of the program means either the capitalization period over which PEC will amortize or depreciate the costs associated with the program or the anticipated period for the program to reach maximum penetration.

have a strong incentive to implement DSM/EE measures regardless of the proposed DSM/EE Procedure, and it is unreasonable to require such customers to pay for PEC's programs, unless they specifically choose to participate. By making it easy for such customers who are not interested in participating to opt-out, the opt-out procedure will support business retention and economic development, and will be easier for PEC to administer. Further, no party opposed the opt-out option and no party presented any evidence that the opt-out mechanism provided for in the DSM/EE Procedure is unreasonable.

Finally, under the DSM/EE Procedure, the costs associated with new DSM/EE programs will be allocated between PEC's North and South Carolina retail jurisdictions, with DSM related costs allocated based on a one-hour coincident peak demand and EE related costs allocated based on energy sales. The DSM/EE Procedure also provides that each EE or DSM program's cost will be allocated to and recovered from those South Carolina retail rate classes eligible to participate in each program. This methodology is reasonable for the allocation and recovery of such costs.

ENVIRONMENTAL INTERVENORS' ALLEGATIONS

The Environmental Intervenor's witnesses Henderson, Tr. 263-288, and Hornby, Tr. 185-225, questioned the DSM/EE Procedure in several ways. Witness Henderson recommended the Commission condition its approval of PEC's proposal by focusing its efforts on EE programs rather than DSM programs. Tr. 285. Henderson also recommended creating an advisory group to determine which DSM/EE programs PEC should offer its customers. In addition, Witness Hornby stated that: (1) PEC had not

proven whether the cost-recovery mechanism contained in the DSM/EE Procedure will produce just and reasonable rates because PEC had not provided actual forecasted DSM/EE costs for use in determining the level of rates; (2) PEC had not proven that receiving a return on PEC's DSM/EE costs and an incentive based upon net savings was reasonable; (3) PEC had not proven that the recovery of net lost revenues is the best method to address the lost sales impact of DSM/EE programs; and (4) the Procedure should include portfolio performance targets. Tr. 214-217. However, on cross-examination Henderson and Hornby seemed to agree that PEC had addressed all of their points and concerns. Tr. 228-255, 291-303.

Regarding Henderson's recommendation that PEC be required to favor EE programs over DSM programs, PEC witness Williams explained that S.C. Code Ann. §§ 58-37-10 et seq. (Supp. 2008) requires South Carolina's electric suppliers to develop 15-year integrated resource plans which must contain the utility's plan "for meeting the requirements shown in its forecast in an economic and reliable manner, including both demand-side and supply-side options." "Demand-side" is defined as including both demand-side resources and energy efficiency. Thus, Williams concluded and the Commission agrees that the South Carolina General Assembly has determined the State's electric utilities are to consider equally and implement both DSM and EE programs as an integral part of their resource mix. Both DSM and EE programs have a strong role to play in a utility meeting their resource needs in a cost effective manner. As further addressed below, Williams also explained that the actual mix of DSM and EE resources a utility should offer depends on its resource needs, customer mix, climate, and rates. On

cross-examination, Henderson agreed that all of these factors must be considered. Tr. 292-294.

Turning to witness Henderson's recommendation that PEC use a comprehensive DSM/EE program development strategy, PEC Witness Williams explained that PEC has done and will continue to do just that. Tr. 41-42. He testified that in 2007, PEC announced a commitment to defer 1,000 MW of power generation requirements over the next ten years through DSM and EE programs. This commitment is part of PEC's long-term, balanced energy strategy to meet the future energy needs of its customers in the Carolinas. PEC has developed several cost-effective programs to help achieve the 1,000 MW reduction in peak demand and associated energy savings. PEC has assembled a staff which is responsible solely for PEC's DSM/EE activities and which reports to the Vice President, Efficiency and Innovative Technology. Witness Williams explained that PEC has contacted other utilities and used well known and respected consulting firms to identify the best programs and practices nation-wide and adapt them to the realities in the Carolinas. Witness Williams stated that these DSM/EE experts are some of the same ones that helped design DSM/EE programs in several of the states witness Henderson recommended South Carolina emulate.

Witness Williams testified that Witness Henderson's references to and reliance on what other states have done with regard to DSM/EE is misplaced. Tr. 42-43. Williams explained that when evaluating what other states have done the Commission should take into account differences in a utility's resource needs, rates, and customer mix. The proper mix of DSM/EE programs is driven by the resource needs of the utility, the

economic and market potential for various measures, and the utilities' rates and avoided costs. Tr. 42. Williams further explained that in states like California, where average electric rates are 78% higher than in South Carolina, or New York with average rates more than double the rates in South Carolina (212%), and commensurately high avoided costs, customers already have a strong incentive to seek out and implement DSM and EE measures, even in the absence of utility sponsored programs. *Id.* In addition, such high rates and avoided costs cause many more programs and measures to be cost effective than is the case in South Carolina, which has average rates 21% below the national average. *Id.*

Witness Williams stated that the utility's mix of customers must also be considered when designing and selecting DSM/EE programs. *Id.* For a utility with a large portion of its load comprised of industrial customers and large commercial customers, its DSM/EE efforts will be materially different from a utility with predominately small commercial and residential load. *Id.* As explained earlier, large commercial customers, such as Wal-Mart, and industrial customers are constantly evaluating and making investments in energy efficiency on their own in order to minimize their cost of doing business. Tr. 43. These large customers conduct research and perform engineering evaluations to identify and implement improvements that are cost effective. That is why in some states, such as North Carolina, these customers are allowed to opt-out of participating in utility sponsored programs and associated rate surcharges. *Id.* Such opt-out provisions are significant factors that can drastically alter any state-to-state comparisons. PEC is proposing to allow such an opt-out opportunity

for its industrial and large commercial customers in South Carolina for the reasons described above, and the Commission has found such an opt-out provision to be reasonable and appropriate. PEC estimates that potential opt-out eligible customers account for approximately 49% of its South Carolina retail energy sales (kWh). *Id.*

On cross-examination Environmental Intervenors' witness Henderson agreed that the particular situation faced by a utility must be considered in selecting, designing and implementing DSM/EE programs. He also agreed that a utility's forecasted resource needs (whether baseload, intermediate or peaking) must be considered as well as the utility's existing resource and customer mix, and the utility's rates compared to other states. Tr. 292-294.

The Commission finds that all of these factors support implementing individualized programs rather than simply copying another states' DSM/EE policy. The DSM and EE experiences in states like New York and California should not be perfunctorily applied to South Carolina due to regional differences in climate, fuel choices, demographics, customer mix, appliance saturation, housing types, and overall energy policies.

With regard to PEC's actual DSM/EE program selection process, witness Williams testified that because North Carolina law requires PEC to obtain North Carolina Utilities Commission ("NCUC") approval prior to offering any new DSM/EE programs and South Carolina law does not, PEC intends to wait until the NCUC approves a DSM/EE program before offering the program in South Carolina. This process is necessary and appropriate because the NCUC may revise or reject a proposed DSM/EE

program. If the NCUC were to do so, and PEC had already begun offering the DSM/EE program in South Carolina, PEC could find itself offering different programs in the two states leading to a deterioration of the overall cost effectiveness of the program.

Witness Williams testified that in North Carolina, PEC has obtained approval of: a residential heat pump, central air conditioner and water heater DSM program; a residential new construction EE program; and a commercial, industrial and governmental new and retrofit EE program. In addition, Williams explained that PEC has four more DSM and EE programs pending NCUC approval. He stated these programs are not all of the programs PEC intends to offer, and it plans to continue to develop additional programs that will be added to PEC's portfolio of programs over the coming months and years, including a low income weatherization program, an appliance program, and a residential lighting program.

According to Williams, the initial set of programs filed in North Carolina is completely consistent with the intended market sector and relative targeted measures as outlined by the intervenor's witness Henderson. This market includes the Existing Residential Sector, New Construction Residential Sector, New Commercial Construction, and Existing Commercial Buildings. Henderson agreed on cross-examination that PEC's proposed programs are similar to those being implemented by the Arizona Public Service Company ("APS"), a utility which Henderson recommended to the Commission. Hearing Exhibit No. 7. Tr. 292.

Williams, offered PEC's Home Advantage Program (residential new construction) as an example of the efforts in designing appropriate programs for the Carolinas. Tr. 179-181. He stated this program focuses on market transformation to more efficient residential building construction by providing incentives to builders who commit to the Energy Star platform and upgrade their HVAC equipment. Currently, this market is largely untapped in South Carolina and lacks adequate infrastructure, including qualified Home Energy Rating System ("HERS") raters, trained builders, and informed realtors, which are fundamental to successful program participation. To address this need, PEC is investing in resources to help identify and support the training of individuals in its South Carolina service territory that can serve as new HERS raters. PEC also plans to offer classes in South Carolina, including builder and training seminars that will provide a sound understanding of Energy Star construction and marketing to grow the number of qualified energy professionals needed to successfully implement the program.

PEC's starter portfolio of DSM/EE programs begins with a core set of programs targeting broad market segments with straightforward, measure-based incentives. As experience is gained, the Company will add more targeted and complex programs. Williams explained that PEC has selected an initial set of programs and measures that help balance the resource planning needs, performance risks, regulatory interests, costs, and customer satisfaction objectives specific to its customer base. The initial programs incorporate design and concepts that have a proven track record of providing benefits in other regulatory jurisdictions around the country.

The program designs adopted by PEC thus far were developed with the assistance of consulting firms and professionals who have extensive roles and experience in providing similar services to many of the utilities cited by Witness Henderson. As an example, PEC's proposed comprehensive Commercial, Industrial, and Governmental Energy Efficiency Program ("CIG EE") was designed and will be implemented with the assistance of the same professional consultant used to design and implement a comparable program at APS. A comparison of the CIG EE program proposed by PEC with that of APS reveals strong similarities. Henderson agreed that PEC's proposed mix of DSM/EE programs is very similar to those offered by APS and specifically cited APS as a utility that achieved quick results even though its energy efficiency endeavors were relatively new. Tr. 287, 292. PEC anticipates similar positive impacts specific to the climate, local economy, and market demographics of its South Carolina service territory.

According to Williams, all of the programs PEC has proposed thus far pass the relevant cost benefit tests and result in significant reductions in energy ("kWh") and demand ("kW") consumption. Moreover, the bundle of measures constituting a program can be modified as the market changes, and the initial slate of programs will be subject to measurement, verification, evaluation, and market acceptance. Williams states that PEC's initial core set of programs will provide a set of cost-effective opportunities to every market sector. PEC has further indicated that it will continue to add to this core portfolio, utilizing the same basic principles combined with the experience that it gains through initial program offerings and market acceptance. Williams stated PEC agrees with witness Henderson's argument that it is important for PEC to develop a network of

private contractors and energy service providers that will be performing the work. To this end, Williams also stated that PEC has made plans to incorporate ongoing training and education specific to each program delivery channel including architects, engineering firms, builders, trade allies, and contractors as well as many of the professional organizations which represent these groups. Williams testified that a whole-systems approach is needed to ensure the successful launch of PEC's programs, and PEC is committed to engaging the relevant participants for each program. We agree with and support PEC's efforts in this area.

Turning to witness Henderson's recommendation that the Commission establish annual performance targets, it was established during cross-examination that the California Public Service Commission is in the process of reviewing the effectiveness of performance targets associated with that state's DSM/EE programs as well as its cost recovery/incentive procedure in general. We take judicial notice of the California Commission's February 4, 2009, order instituting the rulemaking on its own motion to "adopt, repeal, or amend rules, regulations, and guidelines for the electric and gas utilities." In this order the California Commission states: "We believe it is necessary to consider a more transparent, more streamlined and less controversial RRIM [risk/reward incentive mechanism] program. This may require making small but significant changes to the existing RRIM, or may require wholesale adoption of a new incentive mechanism." Hearing Exhibit No. 5.

Furthermore, PEC rebuttal witness Bateman explained in detail why performance targets are not needed in South Carolina. Tr. 147-148. She testified that the Program

Performance Incentive (“PPI”) contained in the DSM/EE Procedure provides a strong incentive to PEC to make every program as successful as possible because the award is based on a percentage of the savings resulting from the program as measured by the Utility Cost Test. *Id.* Therefore, as the program becomes more successful, the incentive award will increase. Bateman stated that establishing performance targets will not provide any greater incentive to offer DSM/EE programs or make such programs more successful than the incentive created by the PPI mechanism, which is tied to actual performance. Tr. 147.

Bateman also testified that establishing overall performance targets is a complex and somewhat subjective undertaking. In order to make any attempt to establish realistic targets, a DSM/EE market potential study must be performed. The results of the market potential study are essential to any attempt to establish realistic and achievable overall portfolio targets. Without these results, any targets are only guesses at what can reasonably be accomplished through a portfolio of DSM or EE programs. She explained that PEC has commissioned such a study that will be complete by the end of March 2009.

Even then, as testified to by Bateman, the results of a market potential study alone are not adequate to create valid goals, and additional factors must be known before target goals can be established with any level of precision. For example, the utility must gain experience with the DSM/EE program implementation process and determine customer acceptance rates. Bateman explained that if appropriate, the issue of performance targets can be revisited in future DSM/EE cost-recovery proceedings after these critical factors

are known, and the Stipulation Agreement contemplates a re-evaluation of the PPI after three years.

We find that the PPI contained in the DSM/EE Procedures provides the greatest incentive possible to encourage PEC to aggressively pursue cost effective DSM/EE programs. We further find that an incentive that grows as DSM/EE program savings grow provides the utility with a substantial incentive to pursue cost effective programs, and performance targets are not necessary at this time.

Turning to Henderson's final recommendation, that the Commission require PEC to establish an Advisory Group, PEC witness Williams testified that the DSM/EE Procedure and the Stipulation Agreement contemplate PEC soliciting the input of all parties to its previous cost-recovery proceeding to assist in PEC's development of new DSM/EE programs. Williams argued no further process is appropriate for input to PEC's resource plan or DSM/EE efforts. He testified that PEC alone is responsible for providing reliable, low-cost electricity to its customers, and PEC alone must defend the prudence, justness, and reasonableness of its costs incurred in doing so. Williams also stated PEC opposes a committee planning process for its resource planning responsibilities, which may focus on only one aspect of resource planning while ignoring the broad scope of objectives that prudent resource planning requires. Williams further provided that while a utility should always be open to others' ideas, a utility must be able to reject the ideas and proposals it finds unreasonable or inappropriate. We agree and find that PEC will solicit and obtain input regarding new DSM programs, which will be subject to the Commission's review, and therefore, no advisory committee is necessary.

In response to witness Hornby's allegation that PEC failed to prove the cost-recovery mechanism contained in the DSM/EE Procedure will produce just and reasonable rates because it lacked actual forecasted DSM/EE costs, Bateman explained that the cost-recovery mechanism contained in DSM/EE Procedure is appropriate for all cost-effective DSM/EE programs to be proposed and allows the Company to recover its actual DSM/EE costs as specifically contemplated by S.C. Code Ann. § 58-37-20. Tr. 144-146. Each program will be reviewed by the Commission before implementation, and the costs associated with the programs are also subject to the Commission's review in the annual proceeding provided for in the DSM/EE Procedure for the purpose of ensuring that only PEC's just and reasonable costs are recovered via the annual rider.

The Procedure provides PEC the option of deferring and amortizing such costs over 10 years with a carrying cost equal to PEC's last Commission-approved overall return. This method allows PEC to only recover its just and reasonable costs and causes the rider to be much lower in the early years than would be the case if all expenses were recovered in the year incurred, which is also compatible with the method advocated by the Environmental Intervenors. This method is in the public interest because it avoids higher rates in the early years of a program before PEC's customers begin realizing program benefits.

Bateman explained that the net present value of expensing all costs in the year incurred, or deferring and amortizing, is the same, but the deferral option included in the DSM/EE Procedure spreads out the cost for recovery purposes in order to keep the rider as low as possible. It also better matches cost recovery with the timing of the benefits of

the programs. Bateman stated, and the Commission agrees, there is no need to have actual DSM/EE costs in order to determine whether this portion of the mechanism is reasonable. A utility should be allowed to recover its just and reasonable costs as this element of the Procedure contemplates. Additionally, Bateman testified that the second element of the DSM/EE Procedure cost recovery mechanism allows PEC to recover its net lost revenues resulting from its DSM/EE programs for three years. To the extent PEC's DSM/EE programs cause its customers to reduce their consumption of electricity, the DSM/EE Procedure makes PEC whole by allowing it to recover its actual net lost revenues.

Finally, Bateman provided that the DSM/EE Procedure allows PEC to recover an incentive to encourage it to pursue DSM/EE resources rather than supply-side resources. This aspect of the proposal allows for PEC to receive an incentive of 8% of the net present value of the Utility Cost Test savings for DSM programs and 13% of the net present value of the Utility Cost Test savings for EE programs. The Utility Cost Test is a nationally recognized test, and the method for calculating it is standardized. The parties to the Stipulation have agreed that incentives of 8% and 13% of these savings as determined by the Utility Cost Test are appropriate. The actual rates resulting from such incentives will provide no additional value in determining whether these are reasonable incentives.

Bateman emphasized that all three elements of the mechanism are expressly supported and justified by S.C. Code Ann. § 58-37-20. While PEC's DSM/EE proposal establishes cost-recovery procedures, the Commission will ensure that the rates produced

by such procedures are just and reasonable by verifying that the costs upon which the rates are based were prudently incurred and are just and reasonable. Therefore, it is not necessary to consider the specific costs to be recovered through a cost-recovery procedure in order to determine whether the procedure itself is appropriate.

S.C. Code Ann. § 58-37-20 specifically requires the Commission to allow a utility a reasonable opportunity to recover its DSM/EE costs, as it provides that a utility must be allowed to recover its costs and obtain a reasonable rate of return on its investment in DSM/EE programs sufficient to make these programs at least as financially attractive as construction of new generating facilities. Under PEC's proposal, if the Company defers recovery of its DSM/EE costs, it will incur carrying costs. Since the expense of the carrying cost associated with PEC's unrecovered DSM/EE costs is a legitimate part of PEC's revenue requirement, the company must be allowed its recovery. As Bateman observed, the recovery of carrying costs is not an incentive, but merely a mechanism to provide for the recovery of costs associated with developing, implementing, and managing the DSM/EE programs.

In adopting S.C. Code Ann. § 58-37-20, Bateman opined that the General Assembly recognized that a utility must be provided both cost recovery and incentives for its DSM/EE programs. Obviously, the greater the incentive, the more aggressively the utility will pursue such programs and measures. The exact level of the appropriate incentive is difficult, if not impossible, to demonstrate empirically. However, the incentive needs to be real and significant enough to cause the utility to develop new DSM/EE programs and measures to satisfy a resource need rather than a supply-side

resource that does not result in lost kilowatt-hour sales and return on investment. Therefore, both a return on unamortized DSM/EE costs and an incentive are necessary and are provided for by the statute. A return on unamortized DSM/EE costs is essential to allow PEC to recover its costs, and an incentive is essential to encourage PEC to aggressively pursue DSM/EE resources rather than supply-side resources in continuing to meet PEC's obligation to provide reliable service to all customers.

CONCLUSION

A recovery mechanism for energy efficiency and demand side management programs offered by a utility should be transparent, reasonably understandable, and consistent with South Carolina Code Ann. Section 58-37-20. The Stipulation presented by Progress Energy and the Office of Regulatory Staff meets these goals consistent with South Carolina Code Ann. Section 58-37-20 by proposing that the Company: (1) recover capital expenditures; (2) recover the actual costs incurred in providing demand side management and energy efficiency programs; (3) recover net lost revenues from these programs; (4) recover incentives equal to 8% of the estimated net savings of demand side management programs as well as 13% of efficiency programs; and (5) defer and amortize all demand side management and efficiency program expenses over a 10 year period. Additionally, Progress's and ORS's proposal will not result in windfall profits and will provide transparency to rate payers, with the unamortized balance of the deferred account earning a return equal to Progress's overall weighted average net of tax rate of return authorized in its last rate case.

However, as an additional regulatory safeguard, the Commission will review and approve Progress' energy efficiency and demand side management programs before they take effect. Progress must submit specific programs, including the initial slate of programs, to the Commission for approval as if they were experimental tariff filings. Unless considered necessary to make findings of fact and/or determine conclusions of law with regard to the programs, the Commission does not anticipate the need for hearings as part of the program approval process.

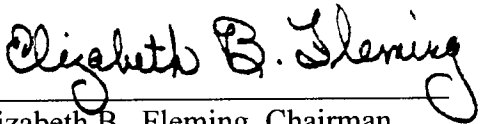
IT IS THEREFORE ORDERED THAT:

1. The Stipulation Agreement and the DSM/EE Procedure contained therein are approved.
2. PEC may recover capital expenditures, the actual costs incurred in providing demand side management and energy efficiency programs, net lost revenues from these programs, incentives equal to 8% of the estimated net savings of demand side management programs as well as 13% of efficiency programs, and defer and amortize all demand side management and efficiency program expenses over a 10 year period.
3. As a regulatory safeguard, the Commission shall review and approve PEC's Energy Efficiency and Demand Side Management programs before they take effect.
4. When submitting specific programs, including the initial slate of programs, to the Commission for approval, these proposed programs shall be treated as experimental tariff filings.

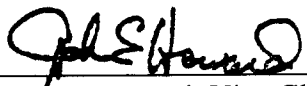
5. Large commercial or industrial customers that elect not to participate in PEC's DSM/EE programs, but subsequently elect to participate in any new DSM/EE program, will lose the right to be exempt from payment of the annual rider for five (5) years or the life of the program, whichever is longer.

6. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Elizabeth B. Fleming, Chairman

ATTEST:


John E. Howard, Vice Chairman

(SEAL)